SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1951

No. 550

AUGUSTO R. SOLTERO,

Petitioner,

vs.

SOL LUIS DESCARTES, TREASURER OF PUERTO RICO, ET AL.,

Respondents

RESPONDENTS' BRIEF IN OPPOSITION

Opinions Below

The opinions of the Tax Court of Puerto Rico (R. 229-241, 248-249) and the opinions of the Supreme Court of Puerto Rico (R. 242-244, 263-267) are contained in the record in English translation. The first opinion of the Tax Court, of January 9, 1947, is reported in 5 D.T.C. 74, in Spanish. Neither opinion has been officially reported in English.

The opinion of the United States Court of Appeals for the First Circuit is reported in 192 F. (2d) 755. The opinion is also printed in full in the Record, pp. 296-305.

Jurisdiction

The judgment of the United States Court of Appeals for the First Circuit was entered on November 8, 1951 (R. 306).

The jurisdiction of this Court is invoked under Section 1254 (1) of the Judicial Code (28 U.S.C.A. 1254). The application is made pursuant to Rule 38, par. 5, subdivision (b) of the Rules of this Court, alleging that the Court of Appeals has in this case decided an important question of federal law which has not been, but should be, settled by this Court and, further, that the Court of Appeals has decided a federal question in a way probably in conflict with applicable decisions of this Court.

Statement of the Case

Since the statement of the case made by petitioner in his brief in support of petition for writ of certiorari (pp. 10-14) has some inaccuracies and omissions the corrections of which respondent considers material to the consideration of the questions presented, the respondent prefers to make his own statement, although following on general lines the order of presentation made by petitioner.

During the years 1942 to 1945 the petitioner, a farmer, cattle owner, accountant, and lawyer (R. 16, 30), grew sugar cane which was ground into sugar at Central Victoria, a sugar mill in Carolina, Puerto Rico, under an agreement whereby the mill got thirty-five per cent of the sugar so obtained and petitioner the remaining sixty-five per cent (R. 38, 47). Petitioner's portion of the sugar was left at the mill with instructions that it be sold for him (R. 17, 18, 37). The sugar was sold by the sugar mill to the Commodity Credit Corporation, a corporate agency of the United States (R. 50), in accordance with purchase contracts providing for the sale of sugar processed by the mill on yearly crop bases (Exhibits 14-16, R. 122-188, admitted at R. 28). Once these contracts were finally liquidated and settled, the mill notified petitioner with a statement showing in detail the amount of money due him for this share of the sugar sold to

Commodity (R. 54 and Exhibit 20, R. 191). This money was paid directly to him by checks of the sugar mill (R. 38, 55). In addition to the above liquidated proceeds from the sugar sold, and in compliance with the purchase contracts, petitioner received, again by checks of the sugar mill, a subsidy from the United States through the Commodity Credit Corporation. The sugar mill participated in this subsidy with the petitioner and even petitioner's portion had to be shared with his laborers (R. 45-46, 51, 168-169). This was all that petitioner received as a result of the sale of his sugar to the Commodity Credit Corporation through Central Victoria.

The additional money received by petitioner was in the form of "conditional payments," in conformity with Title III of the federal Sugar Act of 1937 as amended.[1] These payments were received by petitioner during the period from January 1, 1943 to May 15, 1945,[2] after due compliance with the several conditions established in Title III of the Sugar Act (R. 39-40) and upon applications and certifications crediting the compliance of such conditions and giving other necessary data (Plaintiff's Exhibit 1-3, admitted at R. 18-20; 88-95). The payments amounted to $881.17 for 1942, $1,389.45 for 1943, and $1,224.72 for 1944 (R. 87, 94, 95), and were paid by checks from the Treasurer of the United States (R. 40-41, 87).

In his statement of the case (Brief p. 10) petitioner expresses that:

> Inasmuch as all the sugar thus produced during the years 1943-45 was sold to Commodity in conformity with the provisions of the Sugar Act of 1937 (7 U. S. C. A. 1100 et seq.), petitioner received the basic contractual price plus the conditional payments provided

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[1] 50 Stat. 909-912, as amended December 26, 1941, 55 Stat. 872-873.

[2] Period of operation of the Victory Tax Act. See footnote 4, *infra*.

> for in said statute. Accordingly, during those years petitioner was paid not only the contractual basic minimum price of $3.46 per hundred pounds, but also the further sum of 80 cents per hundred pounds of sugar marketed.

This statement of petitioner is misleading and inaccurate in three ways. (1) It gives the impression that the sugar produced by petitioner was sold to Commodity pursuant to and in compliance with the Sugar Act. Yet this is not correct because said act does not require that the sugar be sold to Commodity (R. 72). (2) It suggests that it was Commodity which, in addition to the price paid for petitioner's sugar, made the conditional payments. It is clear, and the record shows, that said payments were made by the United States Treasury Department (R. 40, 41, 87). (3) It makes the incomplete assertion that petitioner was paid for his sugar not only the contractual price of $3.46 per hundred pounds but also the further sum of 80 cents per hundred pounds of sugar marketed, when the record shows that petitioner was also paid that sum of 80 cents for certain sugar which was neither marketed nor even produced.[3]

During the period of January 1, 1943 to May 15, 1945 there was a statute in force in Puerto Rico which levied a 5% upon certain income—which is described as gross income—of every individual on the Island.[4] This statute was repealed on May 15, 1945 (Laws P. R. 1945, p. 1265).

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[3] Plaintiff's Exhibit 1, R. 89, admitted at R. 18, reveals that although the petitioner actually produced, during the 1943-44 crop year, 1170.64 hundred pounds of sugar (item 1), he was nevertheless paid for 1530.90 hundred pounds (items 11, 12), thus receiving conditional payments for 360.26 hundred pounds of sugar which he did not produce (item 10).

[4] This tax was denominated "the Victory Tax." It was originally enacted on December 7, 1942, and subsequently amended on May 10 and May 15, 1943. (Laws P. R. 1942, 3rd. Sp. Session, p. 160; Laws P. R. 1943, pp. 146 and 630). The relevant sections of the Act are set out in the appendix hereto.

The petitioner did not include in his tax returns filed for those years, under the Victory Tax Act,[5] the conditional payments received by him (R. 44, 83-84, 228-229). The insular treasurer, after giving him opportunity to file additional returns and pay the corresponding tax, which he refused to do, consequently assessed tax deficiencies on the conditional payments. It is convenient to emphasize at this moment that no 5% Victory Tax was assessed on nor paid by petitioner on the proceeds from the sale of his sugar to Commodity, nor on the subsidy paid to him by that corporation (R. 83, 229).

Another misstatement of petitioner should be corrected at this moment. He states that "during all the time the act was in force, the Treasurer did not construe it as applicable to the conditional payments authorized by the Sugar Act" and that "accordingly, no attempt was made during that time to levy or collect the tax on said payments" (Br. 11). It is correct that it was not until four months after the repeal of the Act that petitioner was directed to pay the tax on the conditional payments, but it does not follow from this that the Treasurer considered the statute inapplicable to said payments until then. As a matter of fact, there has never been any official administrative interpretation from the Insular Treasury Department so establishing, nor even has there been any consultation by any taxpayer to the Treasurer to that effect. The record does not warrant the existence of such a ruling or consultation, and the portion of the record (R. 84) from where the petitioner purports to obtain the above assertion explains, through the testimony of Mr. Carlos A. Monagas, that the reason why no steps were taken to collect the tax from the farmers until the Act was repealed was that "at first we had few personnel and the payments were made every six months." "We

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[5] Sections 4 and 7 of the Victory Tax Act, *supra*.

received around 25,000 returns and we spent most of the time liquidating and checking them and we had no time to do anything else" (R. 84). The witness further testified that the Victory Tax Bureau had notified other deficiencies to other farmers and that as a matter of fact there had been many returns voluntarily filed by other farmers (R. 84).

The petitioner, disagreeing with the imposition of the tax on the conditional payments, commenced proceedings before the Tax Court of Puerto Rico. In his complaint he attacked the imposition of the tax on the following grounds: (1) the Act was totally repealed and consequently the Treasurer had no authority to determine any tax pending payments, (2) the saving clause contained in Section 2 of the repealing act was void because the matter to which it referred was not clearly expressed in the title of said Act, (3) the saving clause referred to above, if valid, referred exclusively to taxes already liquidated, and therefore owed, while the Victory Tax was in effect, (4) the Victory Tax Act was void because it violated the uniformity and equal protection clauses of the Organic Act and the Federal Constitution by imposing a tax exclusively on the individual or natural person, (5) the Victory Tax Act, if valid, exempted from its tax the conditional payments received by petitioner because they were derived from contracts of sale, (6) the liquidation of the tax was erroneous, and (7) the conditional payments represented a reimbursement of the increased price of petitioner's sugar and a reimbursement of expenses incurred by him in complying with the conditions imposed on him by the Government in order to receive said payments, this reimbursement being specifically exempted from the Victory Tax.[6]

There was no allegation in the complaint assailing the tax on the ground of undue interference with an agency

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[6] See paragraph 2 of Complaint, R. 2.

or instrumentality of the United States, nor was there any allegation in the sense that the tax violated the commerce clause of the Federal Constitution.

After a trial on the merits, the Tax Court entered judgment for petitioner (R. 241), on the authority of its previous decision in the case of *Teodulo Llamas Muñiz* v. *Tesorero,* 4 D. T. C. 841 (Spanish version). Said judgment was not founded on any of the points posed by petitioner in his complaint, but on a novel theory not raised in the pleadings. The rationale of its decision was that the conditional payments could not constitute *the net incomes of special nature enumerated by the Victory Tax Act* because said payments represented, if not totally, at least in part, a reimbursement of expenses in addition to those which petitioner used to make in his business of planting, cultivating, and harvesting sugar cane (R. 240-241). In so holding the Tax Court simply followed its previous decision in the *Llamas* case, *supra,* where it held that the Victory Tax was in no case levied upon returns of capital investments, nor upon gross receipts *per se,* but upon net amounts of the gross incomes specified in the act. The Court distinguished between gross incomes that comprise *reimbursements* of expenses incurred in order to obtain said incomes and the net incomes of special nature enumerated in the Victory Tax Act, which according to the Court did not comprise *reimbursements* of expenses of any sort. The Court considered the act inapplicable to the former.

As the decision in the *Llamas* case was reversed by the Supreme Court of Puerto Rico,[7] on the ground that the Tax Court committed error in not considering the phrase "and any other income of whatever nature", found in Section 1 of the Victory Tax Act, the support for the decision in the instant case fell, and upon review, the judgment was vacated

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[7] *Buscaglia* v. *Tax Court,* 69 P.R.R. 93.

by the Supreme Court. The case was remanded to the Tax Court with instructions "to decide in the first instance, specifically and definitely, and not generally, why the conditional payments . . . constitute, *under Section 1 of the Victory Tax Act*, a reimbursement, if not totally, at least in part, of the expenses incurred . . . by reason of the Sugar Act of 1937."[8] (Italics supplied.) Additional instructions enjoined the Tax Court to decide, if necessary, the other questions raised by petitioner "such as if the said payments are derived from a contract of sale; whether the Victory Tax is void, for unconstitutionality, as applied to payments authorized by a federal statute;[9] and whether

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[8] The reason for this instruction was the fact that Section 1 of the Victory Tax Act exempted from its effects income obtained "from reimbursements." (See Appendix, *infra.*) But the Tax Court, in its opinion, had used the term "reimbursement," not in the sense it was used in said Section 1, but just to distinguish certain type of gross incomes, which comprise *reimbursements* of expenses incurred in order to obtain said incomes, from what the court called "*net incomes of special nature* enumerated by the Victory Tax Act." The Tax Court considered the Act applicable only to the latter category of incomes, and the conditional payments, not falling within this latter category, were not, therefore, subject to the tax. It is clear that if the Tax Court had found the conditional payments to be income obtained from "reimbursements," in the sense this term is used in Section 1 of the Victory Tax Act, it would have automatically declared them tax exempt without having to resort to the theory of the *Llamas* case, *supra*, which the Supreme Court rejected. But the Tax Court did not do that, and this accounts for the specific instruction of the Supreme Court to consider the "reimbursement" problem *under Section 1 of the Act*. This explanation clears up, also, the inaccuracy of petitioner's statement (Brief, p. 12, first paragraph) in the sense that "since that statute (Victory Tax Act) specifically exempts all reimbursements, it (the Tax Court) entered judgment for plaintiff." (This was not the *ratio decidendi* of the opinion of the Tax Court.

[9] By this time there had been no formal presentation by petitioner of any constitutional question aside from the alleged violation of the equal protection clause of the Organic Act and the Federal Constitution, raised in Paragraph 2(d) of the complaint. (R.3-4) (See ante, page 6). The constitutional question the Supreme Court enjoins the Tax Court to decide—the Supreme Court had already decided in the *Llamas* case, *supra*, the question of the alleged violation of the equal protection clause—can only make reference to a feeble intimation, made by petitioner in his

the Treasurer was authorized to collect the tax after Act No. 175 of 1943 was repealed" (R. 244).

By order of August 19, 1948 and "in accordance with the judgment of the Supreme Court", the Tax Court set for a new hearing of the case on the session of Tuesday, October 19, 1948 (R. 245). This new hearing came to be held on December 15, 1948, when, by stipulation, the case was resubmitted to the Tax Court on the record of the first hearing (R. 246). That court dismissed the case because it lacked evidence to determine "what portion of the so-called conditional payments corresponds to the reimbursement of the additional cost incurred by the petitioner" (R. 248), but did not take into consideration the higher court's instruction to decide the other questions involved.

The Supreme Court of Puerto Rico granted certiorari, and finally affirmed the Tax Court's judgment (R. 263-267). In so doing it held that the evidence contained nothing enabling the court to determine what portion of the conditional payments constituted a reimbursement which would be exempted from the Victory Tax. It also ruled that the conditional payments received by the petitioner were not derived from a contract of sale and consequently were not entitled to exemption under the Victory Tax Act. As to the alleged invalid discrimination against individuals by failing to tax corporations and other artificial persons, the court held that there was no violation of the equal protec-

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brief as appellee in the first occasion that the case came before the Supreme Court, in the sense that the conditional payments were an essential part of a system of public administrative law institutions created by Congress to confront specially the agricultural crisis and generally the national economic depression. Petitioner there said that taxation of the conditional payments would be unconstitutional because it would obstruct and make ineffective the national public policy established by Congress in the Sugar Act of 1937. This intimation was diluted in an elaborate disquisition on economic theories around the federal agricultural legislation. Perhaps, the petitioner had in mind the known constitutional doctrine of the federal government's immunity from state and territorial taxation.

tion clause. Various other points, not material here, raised by petitioner, were disposed of against him by the court. A motion for reconsideration (R. 268-289) was subsequently denied[10] (R. 289).

Appeal was taken by petitioner to the United States Court of Appeals for the First Circuit (R. 290). The points raised on appeal were that (1) the application of the tax to the conditional payments is in conflict with the commerce clause of the Constitution and interferes with an instrumentality of the Federal government; (2) the Victory Tax violates the equal protection clauses of the Organic Act of Puerto Rico and the Fourteenth Amendment to the Constitution insofar as levied on individuals and not on corporations and other artificial persons; (3) assuming the validity of the tax, the conditional payments are a part of the consideration or price paid for sugar sold and, therefore, specifically exempt from taxes by the Act; (4) the conditional payments constitute a reimbursement of additional expenses incurred by sugar cane growers in complying with the requirements of the Sugar Act, and, therefore, specifically exempt from the tax by the Victory Tax Act (R. 293-295).

The United States Court of Appeals for the First Circuit affirmed the judgment of the Supreme Court of Puerto Rico, and as to the aforementioned questions raised, held respectively that: (1) a tax on net income is not a burden

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[10] The petitioner states (Brief, p. 13) that "the Supreme Court of Puerto Rico affirmed the Tax Court's judgment *without deciding itself the constitutional questions involved,*" but in doing justice to the Supreme Court it should be explained that the only constitutional question formally and consistently raised by petitioner from the very beginning of the proceedings—the alleged violation of the equal protection clause—was actually decided by the Supreme Court on the authority of *Buscaglia* v. *Tax Court,* 69 P.R.R. 93 (R. 265). The other constitutional questions posed before this Court were formally raised for the first time in the motion for reconsideration before the Supreme Court of Puerto Rico. See ante, footnote 9.

on interstate commerce, and the Victory Tax certainly is not a gross receipts tax which is generally stricken down as invalid, but it more closely resembles a net income tax; there is no clear and convincing evidence that the Victory Tax thwarts the Sugar Act of 1937 so as to defeat congressional policy; (2) the distinction between individuals and artificial entities is not unreasonable; (3) the interpretation of the Supreme Court of Puerto Rico to the effect that the conditional payments received by the petitioner were not derived from a contract of sale and consequently were not entitled to exemption under the Victory Tax Act is reasonable and justified; (4) the Supreme Court's findings to the effect that the evidence contained nothing enabling the court to determine what portion of the conditional payments constituted reimbursements specifically exempted from the Victory Tax were supported by the record and would be adopted by the court (R. 296-306).

In his petition to this Honorable Court for a writ of certiorari, petitioner does not challenge the aforementioned last two holdings of the Court of Appeals. He limits himself to the former two holdings, which he severs in three separate points or errors relied upon (Brief, pp. 14-15).

ARGUMENT

Summary of Point I

The Commerce Clause of the Constitution does not extend to Puerto Rico. Therefore, the Victory Tax imposed upon conditional payments cannot be a burden upon the interstate commerce. Actually the question to be raised is whether Congress in the exercise of its constitutional power under Article IV, Sec. 3, Cl. 2, of the Constitution, has seen fit to give the insular government power to impose the disputed tax or whether Congress has in any way prohibited its imposition. The sweeping and comprehensive power

granted by Congress to the insular government by the Organic Act includes the authority to impose the Victory Tax Act. Although Congress granted such an ample power, it reserved expressly the power to annul legislation enacted by the Legislature of Puerto Rico. If Congress did not annul the Victory Tax Act, or at least, did not limit its application by a provision in the Sugar Act, or otherwise, prohibiting taxation of the conditional payments, there is no ground for insisting that the Victory Tax is void because it interferes with interstate commerce.

Moreover, the Victory Tax is an additional income tax and not a gross receipt tax. Therefore, the cases that hold taxation on gross receipts from interstate commerce unconstitutional do not control here. The conditional payments received by petitioner are not gross receipts.

Since the conditional payments are not part of the purchase price of the sugar sold, they cannot constitute proceeds of sales in interstate commerce.

Point I

The Commerce Clause of the Constitution, unlike its effect on the power of State legislatures, does not restrict the power of the insular Legislature, for the Commerce Clause does not extend to Puerto Rico, which is not an incorporated territory. *Lugo* v. *Suazo,* 59 F. 2d 386, 390; *Sancho* v. *Bacardi Corporation of America,* 109 F. 2d 57, 62-63, reversed on other grounds, 311 U. S. 150; *Buscaglia* v. *Ballester Hermanos,* 162 F. 2d 805, certiorari denied 332 U. S. 816; *Dorr* v. *United States,* 195 U. S. 138. "The Commerce Clause gives Congress plenary power to regulate our foreign and interstate commerce and thus as a necessary consequence it has the secondary effect of a restriction upon the power of the states in the premises. It thus has two aspects, but in neither of them, either as a grant of federal

power or as a necessarily consequential limitation upon state power, does it affect Puerto Rico. In its aspects of a grant of power to the federal government it adds nothing to the comprehensive power given to Congress by the Constitution (Art. IV, Section 3, Cl. 2) to legislate with respect to national territory, and it can have no consequential effect of limiting territorial action since Congress already has the power under Art. IV, Section 3, Cl. 2 *supra*, to limit such action to any extent it chooses even to the extent of annulling local legislation." *Buscaglia* v. *Ballester Hermanos, supra.*

Hence, the risk of interference with interstate and foreign commerce by the independent state legislatures, which the commerce clause forestalls, need not be apprehended with respect to the dependent insular legislature.

Therefore, if the commerce clause does not affect Puerto Rico, the only question to consider is "whether Congress, in the exercise of its Constitutional power under Article IV, Section 3, Cl. 2, to 'make all needful Rules and Regulations' respecting the Territory of Puerto Rico, has seen fit to give the insular government power to impose the disputed tax", *Buscaglia* v. *Ballester Hermanos, supra*, or whether Congress has in any way prohibited its imposition.

In Section 32 of the Foraker Act (31 Stat. 77, 83, 84) and again in Section 37 of the Jones Act (39 Stat. 951, 964) Congress gave to the insular legislature the general power to legislate in language sweeping and comprehensive in character. *Buscaglia* v. *Ballester Hermanos, supra.* Thus, Section 37 of the Organic Act provides (Appendix, *infra*): "That the legislative authority herein provided shall extend to all matters of a legislative character not locally inapplicable . . ." Referring to this statute, this Court said, in *Puerto Rico* v. *Shell Co.*, 302 U. S. 253, 261:

> The grant of legislative power in respect of local matters, contained in § 32 of the Foraker Act and con-

tinued in force by § 37 of the Organic Act of 1917, is as broad and comprehensive as language could make it.

Further, Section 3 of the Organic Act confers on the insular government specific power to impose taxes by providing "That no export duties shall be levied or collected on exports from Puerto Rico, but taxes and assessments on property, internal revenues, and license fees, and royalties for franchises, privileges, and concessions may be imposed for the purposes of the insular and municipal governments, respectively, as may be provided and defined by the Legislature of Puerto Rico". This section was amended on March 4, 1927 by Section 1 of the Butler Act (44 Stat. 1418) and by this amendment the words "income taxes" were added after the phrase "taxes and assessments on property" in the first sentence of the Section. *Buscaglia* v. *Ballester Hermanos, supra.*

There should be no doubt that the insular government could impose the Victory Tax under this sweeping and comprehensive power granted by Congress.

Moreover, Section 34 of the Organic Act (Appendix), in declaring the extent of the power of Congress to limit Puerto Rican action under Art. IV, Sec. 3, Cl. 2 of the Constitution (Appendix), expressly reserves the power and authority to annul legislation enacted by the insular Legislature. To implement and expedite this power, said Section 34 provides that all laws enacted by the Legislature of Puerto Rico shall be reported to the Congress of the United States, and Section 23 (Appendix) provides "that the Governor of Puerto Rico, within sixty days after the end of each session of the Legislature, shall transmit to the executive department of the Government of the United States, to be designated as herein provided for, which shall in turn transmit the same to the Congress of the United States, copies of all laws enacted during the session." If Congress,

zealous as it has been in expressly reserving its power to annul, has not done so with the Victory Tax Act, or at least, has not limited its application by a provision in the Sugar Act, or otherwise, prohibiting taxation of the conditional payments, there is no ground for insisting that the Victory Tax is void because it interferes with interstate commerce. It is true, as petitioner says (Brief, p. 21), that Congress has never exercised its power to annul Puerto Rican statutes and that yet many insular enactments have been declared unconstitutional, even by the court below itself; but it is clear that this has only occurred whenever the unconstitutional enactment has violated an express legislation of Congress limiting territorial action, passed under its comprehensive power to legislate with respect to national territory, as the case is with the Organic Act of Puerto Rico. If Congress had legislated prohibiting Puerto Rican taxation of conditional payments, any insular tax upon said payments would have been unconstitutional in the same way that insular export duties on exports from Puerto Rico would be unconstitutional because in violation of Section 3 of the Organic Act. But if such prohibitive legislation does not exist, and a general and comprehensive power to tax has been given the Territory, the constitutionality of the tax cannot be assailed with the commerce clause or any other federal constitutional provision not applicable to the Territory.

But this is not all with the Commerce Clause argument.

Assuming, *argumentatis causa*, that the Commerce Clause extends to Puerto Rico, yet, the tax here involved does not violate said clause.

In order to place the conditional payments under the protection of the interstate Commerce Clause, petitioner characterizes the Victory Tax as a gross receipt tax. Then, he tries to avail himself of a series of cases where it has

been held by this Court that a State can neither lay a tax on the act of engaging in interstate commerce, nor on gross receipts therefrom. See *Crew Levick Co.* v. *Pennsylvania,* 245 U. S. 292; *Gwin, White and Prince* v. *Henneford,* 305 U. S. 434; *Joseph* v. *Carter and Weeks S. Co.,* 330 U. S. 422; *Freeman* v. *Hewitt,* 329 U. S. 249; *Spector Motor Service* v. *O'Connor,* 340 U. S. 602. But, none of these cases, and many others, are controlling here. The taxes in those cases involved were exercises of the nature of business, occupation, license, franchise or privilege taxes based on gross receipts. The Victory Tax is not a gross receipt tax imposed on the privilege of doing businesses, carrying on an occupation or any other sort of privilege, neither is it a license or franchise tax measured by gross receipts. 4 *Cooley on Taxation,* Sec. 1742, p. 3477.

Although the nature of a tax does not depend upon labels, *Spector Motor Service* v. *O'Connor, supra,* it is significant that the Victory Tax Act describes the tax as an "additional income tax" (Section 1). Section 8 (Appendix) provides that "the Income Tax Act of 1924 shall be a law supplementary to this Act in everything not provided for herein." The Supreme Court of Puerto Rico has ratified this description of the tax. *Rivera* v. *District Court,* 62 P.R.R. 491; *Diaz* v. *Tax Court,* 64 P.R.R. 147, 149. While the label of the Legislature is not conclusive, it is entitled to great weight in the absence of language in the statute to the contrary. *Lutz* v. *Arnold,* 193 N. E. 840; *Ingels* v. *Riley,* 53 P. (2) 939; *Porto Rico Telephone Co.* v. *Tax Court,* 68 P.R.R. 144, 147.

It is true that the act also describes the tax as one on *gross income,* but gross income taxes are a thing different from *gross receipt taxes.* The terms "gross income" and "gross receipts" are not synonymous. *Doyle* v. *Mitchell Bros. Co.,* 247 U. S. 179. "Gross receipts" is a broader term, including within it receipts which may constitute capi-

tal as well as income. Mertens, *Law of Federal Taxation*, Vol. 1, Sec. 5.10, p. 187; Magill, *Taxable Income*, pp. 344-347. The direct proof that the Victory Tax is not a gross receipt tax is that it excludes from its scope the income derived from the sale of property which does include returns of capital.

Although the act describes the Victory Tax as a "gross income," is it really that? Section 1 begins permitting a deduction of $15.05 a week. In the case of rents, there shall be deducted also any amount actually paid as interest for liens on the property producing the rent. There shall be deducted also the amounts received as compensation for labor accidents, scholarships, the sums paid by the taxpayer during the taxable year for premiums on his life insurance policies, or on the life insurance policies of his wife or children, and on insurance policies against accidents, or for educational purposes, up to an aggregate insurance of $25,000, the sums obtained or collected on life insurance policies, or on insurance policies against accidents or for educational purposes during the life of the insured, and the sums paid as compensation for cultural or artistic activities sponsored by the University of Puerto Rico or by any organization or association not for pecuniary profit. In the case of contracts for the performance of works, labor, or services, the cost of the materials and labor may be deducted also. In the presence of this panorama of deductions allowed by the Victory Tax Act we can hardly say that the tax is one on gross income.

"Income" is not a rigid term. The difference between "gross" and "net" income is only a matter of degrees. It is now generally agreed that the income tax is not limited to "net income" but may under certain circumstances be imposed upon gross income. The courts have repeatedly viewed deductions as matters of legislative grace, so that

"net income" becomes a statutory rather than an economic concept under which items which might be considered as gross income by the businessman are treated as taxable income by statute. Mertens, *Law of Federal Income Taxation*, Vol. 1, Sec. 5.10, pp. 186-187. This Court has said that: "Unquestionably Congress has power to condition, limit or deny deductions from gross income in order to arrive at the net that it chooses to tax." *Helvering* v. *Independent Life Insurance Co.*, 292 U. S. 371. Thus a categoric distinction between "net" and "gross" income cannot be made. An income can be "less gross" or "more gross," "less net" or "more net," depending upon the deductions allowed by the statutes. The Supreme Court of Puerto Rico, in construing the phrase "gross income", as used in Section 1 of the Victory Tax Act, has acknowledged the allowance by the Act itself of the specific and significant deductions mentioned above and has held to be the duty of the Treasurer to grant all those deductions and exemptions to taxpayers. *Buscaglia* v. *Tax Court*, 69 P.R.R. 93, 104-105.[11] Hence, the Victory Tax, even though described in the act as a "gross income" tax, is more or less a net income tax.

Although, as stated hereinbefore, local taxes measured by gross receipts from interstate commerce have been pronounced unconstitutional, net income taxes have been held by this Court not to burden interstate commerce. *United States Glue Co.* v. *Oak Creek*, 247 U. S. 323.

Something else should be added against petitioner's argument on the commerce clause, assuming, *arguendo*, that said clause extends to Puerto Rico. Petitioner's major

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[11] Petitioner, citing *De Castro* v. *Board of Commissioners*, 322 U. S. 451, says (Brief, p. 15) that "it hardly behooves the Court of Appeals below to hold, as it did (R. 304), that the exaction more closely resembles a net income tax." But the correct thing to say is that the Supreme Court of Puerto Rico has interpreted the tax to be one on gross income less specific and significant deductions, which is just to say a tax on net income. The Court of Appeals is, thus, just ratifying the Supreme Court's holding.

premise is the elementary proposition "that a state can neither lay a tax on the act of engaging in interstate commerce, *nor on gross receipts therefrom*" (Brief, p. 18); his minor premise: that the conditional payments are gross receipts from interstate commerce;[12] his conclusion: that a state cannot [nor Puerto Rico either] lay a tax on the conditional payments. But, for two reasons petitioner's minor premise is erroneous.

1. In order to establish that the conditional payments are gross receipts from interstate commerce the petitioner has had to say that said payments are "the proceeds of sales of sugar grown and produced by petitioner to be sold for immediate and direct shipment in interstate and foreign commerce," that they "are an effective and substantial part of the returns obtained by the producer from the sale of his sugar," and that they are "an amount of money which petitioner received from the Secretary of Agriculture in return for his marketing of sugar in interstate commerce" (See Petitioner's brief, pp. 17-18); but said assertions are unwarranted. If the conditional payments had been proceeds of sales received by petitioner they would have been exempted from the Victory Tax under the specific terms of Section 1 of the Act (See Appendix), and no need would have been of recurring to the commerce clause argument. But the Supreme Court of Puerto Rico held that the payments received by petitioner from the Federal Government were not derived from a contract of sale and consequently were not entitled to exemption under the Victory Tax Act (R. 264-265). This the Court of Appeals below considered a reasonable interpretation (R. 301), and petitioner has not challenged before this Court the Court of Appeals' holding,

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[12] Petitioner does not purport that the Victory Tax is a tax on the act of engaging in interstate commerce.

although he had challenged the Supreme Court's holding before the court below.

That the conditional payments are not proceeds of the sales of sugar clearly comes out from petitioner's own evidence before the Tax Court and from the provisions of the Sugar Act of 1937. The conditional payments were not mentioned anywhere in the purchase contracts of sugar, made between the Commodity Credit Corporation and the sugar mill, as agent of petitioner, and constituted no part of the consideration to be paid by Commodity in exchange for the sugar. (Plaintiff's Exhibits 14, 15 and 16, R. 122-188, admitted at R. 28). The sale was accomplished without the conditional payments. Even though the payments had not been made Commodity would have acquired the sugar by virtue of the purchase contracts. Nowhere from the Sugar Act can be obtained the proposition that the conditional payments are part of the price received by the sugar producers. The payments were received by petitioner solely and exclusively upon compliance with the conditions prescribed by Congress in Section 301 of the Sugar Act of 1937 (R. 39), and they were received by him directly from the United States Secretary of Agriculture by checks from the Treasurer of the United States (R. 40-41, 87), with which the sugar mill had nothing to do as seller and liquidator of petitioner's sugar. Normally the payments were made approximately one year after the cutting of the sugar cane and by this time the sugar might or might not have been sold at the market (R. 42-43). It is significant to note that those payments were estimated on 100% of the sugar produced by the petitioner (R. 47), although 35% of the sugar belonged to the sugar mill under the grinding agreement (R. 38, 47). The payments were determined by the United States Secretary of Agriculture, irrespective of the sugar production and without taking into consideration any of the circum-

stances connected with the contracting, sale, or disposal of sugar. Section 303 of the Sugar Act authorizes additional conditional payments to cover the abandonment of planted acreage and crop deficiencies resulting from drought, flood, storm, freeze, disease, or insects which cause damage to all or substantial part of the crop. As a matter of fact petitioner received conditional payments for sugar which he did not sell, nor even he did produce because of drought (Plaintiff's Exhibit 1, R. 89 and ante, footnote 3). Under such factors it is unjustifiable to consider those payments as part of the price of sugar sold in the market.

In addition, the record shows that even though the sugar produced by petitioner would have been destroyed by fire, hurricane or flood, while warehoused and before marketed, yet he would have received the corresponding conditional payments (R. 73-74, 78). This evidence proves that what made petitioner worthy of receiving those payments was solely his compliance with the conditions of the Sugar Act as a matter of public policy and for the benefit and welfare of the community in general. Petitioner's contention that "no payment can be made unless the producer markets his sugar" (Br. 18) is absolutely erroneous and unwarranted by his own evidence (R. 74).

Petitioner's only basis for his proposition has been an argument on politics and economics. He has tried to arrive at the conclusion that conditional payments are part of the purchase price of sugar by considerations of the historical and economical background of the Sugar Act of 1937 and its political and economic purposes and motives (Br. 17-18). Since the object and purpose of the Sugar Act—the argument goes—is the stabilization of the sugar industry and the restoring of the purchasing power of farmers to a parity level with other producers, "it would seem quite clear that the payments therein provided for constitute in

substance and effect an additional price paid for the sugar produced."

Not in the least underrating the immense value of politics and economics to law and culture, respondent submits that petitioner's above economic and political argument does not warrant the legal conclusion that the conditional payments are proceeds of sale. Economists and lawyers do not seem to have the same point of view in the interpretation of laws. "The legal universe of discourse and the economic universe of discourse are not always the same."[13] "The need for a workable, practicable system of producing revenue necessitates a refusal by the courts to enter into the refinements of economists and lexicographers."[14] Petitioner's proposition is mere speculative theory, inconsistent with the evidence produced and with the provisions of the federal laws. Therefore, the minor premise of the commerce clause argument is erroneous.

2. Even assuming that the conditional payments were part of the purchase price of petitioner's sugar and, therefore, proceeds of the sale of such sugar, yet it by no means follows from this that they were petitioner's *gross receipts* from the sale of his sugar. Petitioner received from the Commodity Credit Corporation, as price of the sugar sold, a basic minimum of 3.46 cents per pound plus an additional subsidy that was to be treated as part of the price. These proceeds did not include the conditional payments and were the larger portion of the total proceeds. On this larger portion of the proceeds no 5% Victory Tax was assessed nor paid by petitioner. The tax was assessed and paid on the other smaller portion of the proceeds which were constituted by the conditional payments. It can hardly be said that a tax has been laid on *gross receipts* from sugar sold

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[13] T. R. Powell: *New Light on Gross Receipt Taxes,* 53 Harvard Law Review 909, 924 (1940).

[14] Mertens, *Law of Federal Income Taxation,* Vol. 1, Sec. 5.03, p. 162.

in interstate commerce when the larger and substantial part of the proceeds were not affected by the tax. The Puerto Rican government did not tax the referred larger portion precisely because it considered it exempt under Section 1 of the Victory Tax Act as proceeds obtained from sales in which petitioner was a contracting party.

Since petitioner's minor premise of the commerce clause argument is erroneous, the argument is illogical and fallacious.

Finally, even if for the sake of argument we accept the conditional payments to have been the total proceeds of the sale of the sugar, and, therefore, the gross receipts thereof, yet the fact should be considered that this Court has held certain taxes on gross receipts not to interfere with or burden interstate commerce. *Western Live Stock* v. *Bureau*, 303 U. S. 250.[15] Respondent submits that under no circumstances the Victory Tax laid upon the conditional payments involved in this case violates the Commerce Clause of the Constitution.

Summary of Point II

The decisions of this Court indicate an increasing disinclination to strike down tax laws of the states on the basis of merely implied constitutional restrictions. The policy to be implied would be one to preserve and recognize, not to strike down, the states' power to tax. Under this policy this Court has held that income taxation on the salaries of federal officers or employees is not illegal under the constitutional doctrine of immunity of the Federal Government

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[15] For recent detailed studies on this problem of taxation of interstate commerce we respectfully refer to: Robert C. Brown, *State Taxation of Interstate Commerce—What Now?*, 48 Michigan Law Rev. 899; Landon G. Rockwell, *Justice Rutledge on State Taxation of Interstate Commerce*, 35 Cornell Law Quarterly 493; Wallace Mendelson, *Recent Developments in State Power to Regulate and Tax Interstate Commerce*, 98 Univ. of Pa. Law Rev. 57.

from state taxation. By the same reasoning, income taxation upon conditional payments obtained pursuant to the Sugar Act of 1937 is not illegal under said doctrine.

Congress has ample power and discretion to grant statutory immunity from taxation to any federal instrumentality. Nothing could have prevented Congress from declaring said conditional payments free from local taxation, but it chose not to do it.

Point II

Although somewhat concealed in between economic concepts around the Sugar Act of 1937 and the Agricultural Adjustment Act of 1938, petitioner's second point of argument is that the Victory Tax Act, in taxing conditional payments, imposes an undue tax or burden upon an agency or instrumentality of the Federal Government. Petitioner contends that the conditional payments are one of the instruments in the Sugar Act devised to carry into effect the declared policy of Congress as to the orderly marketing of sugar in interstate commerce, and that no tax may burden the operations of such instrument.

The contention has been decisively decided against petitioner. *Alabama* v. *King & Boozer,* 314 U. S. 1; *Penn. Dairies, Inc.* v. *Milk Control Commission,* 318 U. S. 261; *Oklahoma Tax Commission* v. *Texas Co.,* 336 U. S. 342; *Graves* v. *N. Y. ex rel. O'Keefe,* 306 U. S. 466; *Rivera* v. *Buscaglia,* 146 F. 2d 461. In *Alabama* v. *King & Boozer, supra,* this Court held that no constitutional immunity of the United States from state taxation prevented a State from applying its sales tax to a purchase of building materials by one who bought them for use in performing a "cost-plus" building contract for the Government, even though the economic burden of the tax was passed on to the United States. In the recent case of *Oklahoma Tax Commission* v. *Texas Co., supra,* after an exhaustive con-

sideration of the question, this Court held that the State of Oklahoma could impose gross production taxes and excise taxes on producers operating on Indian lands, under the jurisdiction of the United States, through contracts that constituted instrumentalities of the Federal Government. According to this case, Congress has ample power and discretion to grant statutory immunity from taxation to any instrumentality it wishes. Its power to determine that a State may not tax a federal instrumentality is absolute, if it keeps within its constitutional scope.

Assuming, *arguendo*, that the conditional payments were an instrumentality of the United States, nothing could have prevented Congress from declaring said payments free from all local taxation.

In the case of Puerto Rico, a dependency of the United States, the federal immunity comes out, not from the mutual respect of sovereigns, as in the case of states, but through the reason that a territory or possession may not tax its sovereign. *Domenech* v. *National City Bank*, 294 U. S. 199. But as it was indicated by the Court of Appeals below in *Rivera* v. *Buscaglia*, 146 F. 2d 461, 463, following this Court's opinion in *Graves* v. *N. Y. ex rel. O'Keefe*, *supra*:

> It may be conceded that the power of a dependency to tax its sovereign will not readily be implied, and that the grant by Congress to the Legislature of Puerto Rico of a general power to tax should not be construed as consent to the imposition of taxes on the United States itself or any of its agencies or instrumentalities. . . . But it by no means follows from this that a further qualification should be read into the broad taxing authority conferred by the Organic Act, so as to exempt the salaries of federal employees from insular income taxes. After all, the ultimate responsibility for the government and welfare of the people of Puerto Rico rests with Congress. In the discharge of this responsibility, Congress has established the insular govern-

> ment. There is no a priori reason to suppose that Congress would not have wished federal employees in Puerto Rico, along with other residents, to bear their full share of the cost of maintaining the local government. . . .

Paraphrasing another very recent federal circuit court's (Ninth Circuit) opinion [16] on a similar question, we may say that by the Organic Act Puerto Rico has been granted the privilege of legislating, including the laying of taxes and the collection of revenue, in much the same manner as a state. And with respect to the states, it is recognized that the successful operation of our federal system can be accomplished only if the state legislature may have reasonable latitude in providing for the collection of revenue from those who are indebted to the state for a measure of protection. And while the state's taxing power must be exercised subject to the limitations set by the due process and the equal protection requirements of the Constitution, the decisions of this Honorable Supreme Court indicate an increasing disinclination to strike down tax laws of the states on the basis of merely implied constitutional restrictions. Illustrative of this tendency are such cases as *Graves* v. *N. Y. ex rel. O'Keefe, supra,* and *Oklahoma Tax Commission* v. *Texas, supra,* both overruling earlier decisions of the Court. These decisions, we think, are illustrations of a general policy of noninterference with the effort of the states to collect taxes from sources within the states. Undoubtedly the United States is concerned with employing and compensating federal officers. The *Graves* case, *supra,* declined to imply from this a prohibition of a state tax on a federal officer's salary. The oil leases on Indian lands considered in the *Oklahoma Tax Commission* case, *supra,* were executed pursuant to the federal policy concerning

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[16] *Alaska Steamship Co.* v. *Mullaney,* 180 F. 2d 805.

the Indians, yet nothing about that policy precluded the state's power to impose a gross production tax on the lessee. Recognition of the state's power to tax was itself a policy entitled to respect. We think any policy to be implied would be one to preserve and recognize, not to strike down, the Territory's power to tax. We know of no Congressional enactment and of no express or implied policy opposed to Puerto Rico's requiring the payment of an additional income tax upon the conditional payments paid in the Island to sugar producers. (180 F. 2d at pages 813-814).

An application of the Victory Tax Act to salaries of federal employees was sustained by the Court of Appeals below in *Rivera* v. *Buscaglia, supra,* and we think that all that was said there, toegther with what this Court said in *Graves* v. *N.Y. ex rel. O'Keefe, supra,* is perfectly applicable to the problem here.

Although petitioner fully realizes the recent restrictions of the concept "agency or instrumentality of the Federal Government" (Br. 24), nevertheless, he tries to distinguish between the conditional payments on one side and the income derived by individuals or firms rendering services on the other. As to the former he says that "a State may not tax the operations of an instrument employed by the government of the Union to carry its constitutional powers into operation"; as to the latter he says that "no particular statutory means or methods are involved, no onerous conditions are to be previously complied with, no stabilization of any industry affecting interstate commerce is concerned, no legislatively devised method to foster commerce and avoid ruinous competition in it is at stake." But, are not the salaries of federal officials or employees, in a more significant way, instruments employed by the Government of the Union to carry its constitutional powers into operation?

In a similar way to the conditional payments, said offices and salaries are created by legislative action, they impose on the recipient onerous conditions, and, verily unlike the conditional payment, their disappearance would put an end to the government itself.

The case of *Kennecott Copper Corporation* v. *State Tax Commission*, 60 F. Supp. 181,[17] cited by petitioner, adds nothing to his contention. The claim made there that the inclusion of the subsidy for war production in the tax base interfered with the war powers of Congress was not passed over by this Court on review. Moreover, the *ratio decidendi* of the District Court was that the subsidy was a gift from the government and not part of sales price and, therefore, should not have been included in fixing amount of occupation tax on gross-sales.

Curiously enough a more recent case has decided that the same subsidy for war production, paid to the same Kennecott Copper Corporation by the United States, pursuant to an order of the Office of Price Administration, should be included, as per determination of local law, in the tax base of ad valorem taxes laid upon the corporation and its properties located in the state. See *Salt Lake County* v. *Kennecott Copper Corporation*, 163 F. 2d 484. In this case the question was specifically raised as to whether the inclusion of the subsidy payments in the tax base constituted taxation of the means used by the United States in the prosecution of the war, and, thus, constituted an undue imposition upon the property or activities of the Federal Government, or any of its instrumentalities. Citing the authority of this Court and referring to the principles hereinbefore mentioned the Court held that "the inclusion of the premium or subsidy payments in the fixing of the tax

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[17] Reversed on jurisdictional grounds in 150 F. 2d 905, cert. granted 326 U.S. 711, affirmed 327 U.S. 573.

base did not amount to a tax against the United States, its instrumentality, its activities, or its property; and it did not contravene any constitutional implication forbidding a tax under state law against the United States or its interests." (163 F. 2d at page 487).

Respondent submits that the imposition of the Victory Tax upon the conditional payments received by petitioner does not burden the Federal Government or its instrumentalities.

Summary of Point III

The imposition of the Victory Tax upon the gross income of individuals and not upon the gross income of corporations and other artificial persons does not violate the equal protection clause of the Organic Act of Puerto Rico. Such classification is not unreasonable. A distinction in legislation is not arbitrary if any state of facts reasonably can be conceived that would sustain it. Two conceivable bases exist which would sustain the Victory Tax discrimination: (1) the Legislature had in mind the difference of treatment which in local taxation was accorded to individuals and artificial entities and was attempting to prevent unequal economic burdens, (2) the Legislature considered the tax measure as an anti-inflation device during the war period, in which device corporations could not take part.

Point III

Petitioner contends that the Victory Tax Act violates the equal protection clause of the Fourteenth Amendment and of the Organic Act of Puerto Rico (Sec. 2, 39 Stat. 951; See Appendix), because it discriminates against him as an individual and in favor of artificial entities.

The constitutional doctrine of the equal protection of the laws as applied to taxation has been so abundantly ex-

pounded by the courts that its principles have been repeated thousands of times.

The power of taxation is fundamental to the very existence of the government of the States. The restriction that it shall not be so exercised as to deny to any the equal protection of the laws does not compel the adoption of an iron rule of equal taxation, nor prevent variety or differences in taxation, or discretion on the selection of subjects, or the classification for taxation of properties, businesses, trades, callings, or occupations. *Tax Commissioners* v. *Jackson*, 283 U. S. 527, 537. The area of permissible legislation for state legislatures is extremely broad. *Wisconsin* v. *J. C. Penney Co.*, 311 U. S. 435. While it has often enough been recognized that a statutory classification may be so invidious and lacking in rational basis as to offend the constitutional guaranties, the cases are few and far between in which a tax law has actually been invalidated on this ground. In the tax field, more than in any other, legislatures possess the greatest freedom in classification. Since the members of a legislature necessarily enjoy familiarity with local conditions which this Court cannot have, the presumption of constitutionality can be overcome only by the most explicit demonstration that a classification is a hostile and oppressive discrimination against particular persons and classes. *Madden* v. *Kentucky*, 309 U. S. 83; *Rivera* v. *Buscaglia*, 146 F. 2d. 461. If the classification is neither capricious nor arbitrary, and rests upon some reasonable consideration of difference or policy, there is no denial of the equal protection of the laws. *Tax Commissioners* v. *Jackson, supra.* This broad area of permissible legislation of state legislatures and their great freedom in classification, specially in in the tax field, is also enjoyed by the Legislature of Puerto Rico. Its discretion as far as local matters are concerned is not a great deal narrower than that of the state legisla-

tures. *People of Puerto Rico* v. *Shell Co.*, 302 U. S. 253; *South Porto Rico Sugar Co.* v. *Buscaglia*, 154 F. 2d 96, 100.

It has been very well established by this Court that a distinction in legislation is not arbitrary, if any state of facts reasonably can be conceived that would sustain it, and the existence of that state of facts at the time the law was enacted must be assumed. It makes no difference that the facts may be disputed or their effect opposed by argument and opinion of serious strength. It is not within the competency of the courts to arbitrate in such contrariety. *Lindsley* v. *Natural Carbonic Gas Co.*, 220 U. S. 61, 78; *Rast* v. *Van Deman & Lewis*, 240 U. S. 342, 357; *Tax Commissioners* v. *Jackson*, *supra*.

Petitioner seems to be scared at this doctrine, which has been consistently expounded in a long line of decisions of this Court, and forces out the proposition that if there be circumstances which will justify the classification, *it is for the Legislature to point them out*. But this Court has held that a legislature may make distinctions of degree having a rational basis, and when subjected to judicial scrutiny they must be presumed to rest on that basis if there is any conceivable state of facts which would support it. This restriction upon the judicial function, in passing on the constitutionality of statutes, is not artificial or irrational. A state legislature, in the enactment of laws, has the widest possible latitude within the limits of the Constitution. In the nature of the case it cannot record a complete catalogue of the considerations which move its members to enact laws. In the absence of such a record courts cannot assume that its action is capricious, or that, with its informed acquaintance with local conditions to which the legislation is to be applied, it was not aware of facts which afford reasonable basis for its action. Only by faithful adherence to this guiding principle of judicial review of legislation is it possible to preserve

to the legislative branch its rightful independence and its ability to function. *Carmichael* v. *Southern Coal Co.*, 301 U. S. 495, 509; *Madden* v. *Kentucky, supra; Flusbury Hospital* v. *Cass County,* 326 U. S. 207, 215.

The burden is on the one who attacks as invalid a legislative enactment to negative every conceivable basis which might support it. Petitioner has not sustained this burden in attacking the Victory Tax Act as invalid. There are at least two conceivable bases which might support the tax and which have not been negatived by petitioner.

The first one was pointed out by the Supreme Court of Puerto Rico in *Buscaglia* v. *Tax Court,* 69 P.R.R. 93, 103, where the same question was involved. The Legislature might have had in mind the fact that the general Income Tax Act [18] of the Island differentiates between individuals and artificial persons, levying on each of said classes different tax rates and granting to each of them different deductions and credits, the artificial persons having the higher rates and the lesser credits. Furthermore, in addition to the income tax which every artificial person is bound to pay, its component members or stockholders must pay, as individuals, the tax corresponding to dividends or benefits received from the artificial person, which amounts to a double economic burden. Moreover, since the Victory Tax Act taxes dividends from corporations and benefits in partnerships, the imposition of the tax on corporations and partnerships would amount to another double economic burden. It is conceivable, therefore, that the Legislature, in not taxing artificial entities, had in mind the difference of treatment between them and individuals and was attempting to prevent unequal economic burdens.

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[18] Income Tax Act of 1924, Laws P. R. 1925, Sections 12, 13, 18, 28 and 34.

The second conceivable basis to support the tax was already suggested by the Supreme Court of Puerto Rico in *Rivera* v. *District Court,* 62 P.R.R. 491, 510-511, affirmed in 146 F. 2d 461, and was adopted by the court below. The Supreme Court of Puerto Rico pointed out that the apparent purpose of the law, as suggested by the Attorney General, was to serve as a measure tending to avoid inflation during the war emergency. In 1942, when the Victory Tax Act was passed, war was at its height. Military bases were being established in Puerto Rico and existing ones were being enlarged and extended. These activities, together with military conscription, gave occasion for the need of more hands. A great number of laborers were hired and unemployment disappeared. The consequence was that money began to circulate in great amounts, giving rise to a fictitious temporary prosperity based upon an ephemeral economy of war emergency.

On the other side, the staple foods consumed in Puerto Rico came in 1942, from the outside of the Island in a large proportion, and, on account of war, the shipping was limited. Some cargos came to be sunk by the enemies' action. So, we had by one side the purchasing powers of individuals greatly increased for the moment, while on the other side we had scarcity of many staple food items. This situation threatened inflation of the prices of staple foods.

Section 6 of the Victory Tax Act (see Appendix) shows that the Legislature had in mind the above described situation, and that it took into consideration the economic conditions of the Island, when such emergency measure was approved. The tax was to be in force only up to six months after the cessation of hostilities between the United States and Germany, Italy and Japan (See appendix, Section 1). Section 6, together with Section 1, offers a scheme to avoid inflation of the staple foods of Puerto Rico. Since corpo-

rations and other artificial persons were not, as such, consumers of rice, beans, milk, etc., they could not play any part in the plan of anti-inflation. It is true, as petitioner points out, that artificial persons purchase large quantities of staple food products, but they cannot consume, eat, such products, and they just sell them to individuals for consumption. Thus, the individual is necessarily the key of the anti-inflation device. Therefore, in compliance with its purpose, the act could only tax individuals and not artificial persons.

"It is not the function of this Court in cases like the present to consider the propriety or justness of the tax, to seek for the motives or to criticize the public policy which prompted the adoption of the legislation." *Tax Commissioners* v. *Jackson supra;* this Court cannot review the economics or facts on which the legislature of a state bases its conclusions that an existing evil should be remedied by an exercise of the police power. *Central Lumber Co.* v. *South Dakota,* 226 U. S. 157, 158. Deference is due to the judgment of the legislature on the matter. *Dominion Hotel* v. *Arizona,* 249 U. S. 265, 268.

The cases cited by petitioner in behalf of his argument do not run against the validity of the Victory Tax. The circumstances that caused them were absolutely different from those of the case at bar. *Quaker City Cab Co.* v. *Pennsylvania,* 277 U. S. 389, invalidated a tax which could be laid upon receipts belonging to a natural person quite as conveniently as upon those of a corporation. The character of the owner was the sole fact on which the distinction was made to depend. The tax was imposed merely because the owner was a corporation, there existing no rational basis to justify the classification. The same is true with *Frost* v. *Corporation Commission,* 278 U. S. 515, which is not a tax case, but which invalidated a statute that demanded from

individuals, in order to engage in a certain type of business, requirements which it did not demand from corporations, in order to engage in the same business. The distinction was not based upon real or substantial differences having reasonable relation to the subject dealt with by the legislation. But, the circumstances of the case at bar are different, and we have just pointed out reasonable bases for the classification made in the Victory Tax Act.

Petitioner cites as leading the Oregon case of *Redfield* v. *Fisher*, 292 Pac. 813, cert. den. 284 U. S. 617, but the rationale of said case was made to rest on the ground that the tax in question was a property tax and not an income tax. Cf. *Hale* v. *State Board*, 302 U. S. 95, 105. We have demonstrated (Point I) that the Victory Tax was an additional net income tax. It suffices here to say that the proper Supreme Court of Oregon has impliedly repudiated the rationale of the *Redfield* case. See *Middlekauff* v. *Galloway*, 99 P. 2d 24, 26.

More in point to the question involved in the case at bar is the New Hampshire case of *Conner* v. *State*, 130 Atl. 357, where it was held that an income tax upon dividends and interests was not unconstitutional because it failed to tax corporations, since the Legislature had the right to make such a reasonable classification (130 Atl. at page 360).

The indication of the Court below that the distinction between individuals and artificial persons is not unusual in the federal tax structure is supported by cases like *Fort Smith Lumber Co.* v. *Arkansas*, 251 U. S. 532, and *Flint* v. *Stone Tracy Co.*, 220 U. S. 107. Other cases that upheld said classification, although not tax cases, are: *Crescent Oil Co.* v. *Mississippi*, 257 U. S. 129, and *Bain Peanut Co.* v. *Pinson*, 282 U. S. 499.

For the reasons above stated respondent submits that the classification between individuals and artificial persons

encountered in the Victory Tax Act is consistent with the equal protection clause.

Conclusion

The decision of the Court of Appeals as to the taxing act's discrimination between individuals and artificial persons is not in conflict with applicable decisions of this Court and none of the other two questions decided by the Court of Appeals are important questions of federal law which has not been, but should be, settled by this Court. All of the questions raised in the petition can be and were decided by the authority of decisions of this Court for a long time established. Therefore, the writ of certiorari prayed for should not be granted.

Respectfully submitted,

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February, 1952.

DARK PAGE BLEED THRU

APPENDIX

Constitution of the United States of America:

ARTICLE I

* * * * * * *

Section 8. The Congress shall have Power . . .
To regulate commerce with foreign Nations, and among the several States, and with the Indian Tribes;

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ARTICLE IV

* * * * * * *

Section 3. . . .
The Congress shall have Power to dispose of and make all needful Rules and Regulations respecting the Territory or other Property belonging to the United States; . . .

Organic Act of Puerto Rico (Act of March 2, 1917), c. 145, 39 Stat. 951, as amended by the Act of May 17, 1932, c. 190, 47 Stat. 158:

Sec. 2. That no law shall be enacted in Puerto Rico which shall deprive any person of life, liberty, or property without due process of law, or deny to any person therein the equal protection of the laws. (48 U. S. C. 1946 ed., Sec. 737.)

Sec. 3 [as amended by Acts of March 4, 1927, c. 503, 44 Stat. 1418, Sec. 1]. That no export duties shall be levied or collected on exports from Puerto Rico, but taxes and assessments on property, income taxes, internal revenue, and license fees, and royalties for franchises, privileges, and concessions may be imposed for the purposes of the insular and municipal governments, respectively, as may be provided and defined by the Legislature of Puerto Rico; . . .

And it is further provided, That the internal-revenue taxes levied by the Legislature of Puerto Rico in pursuance of the authority granted by this Act on articles, goods, wares, or merchandise may be levied and col-

lected as such legislature may direct, on the articles subject to said tax, as soon as the same are manufactured, sold, used, or brought into the island: *Provided,* That no discrimination be made between the articles imported from the United States or foreign countries and similar articles produced or manufactured in Puerto Rico. The officials of the Customs and Postal Services of the United States are hereby directed to assist the appropriate officials of the Puerto Rican Government in the collection of these taxes (48 U. S. C. 1946 ed., Secs. 741 and 741a.)

Sec. 23. That the Governor of Puerto Rico, within sixty days after the end of each session of the Legislature, shall transmit to the executive department of the Government of the United States, to be designated as herein provided for, which shall in turn transmit the same to the Congress of the United States, copies of all laws enacted during the session (48 U. S. C. 1946 ed., Sec. 842).

Sec. 34. . . . All laws enacted by the Legislature of Puerto Rico shall be reported to the Congress of the United States, as provided in section twenty-three of this Act, which hereby reserves the power and authority to annul the same. . . . (48 U. S. C. 1946 ed., Sec. 826.)

Sec. 37. That the legislative authority herein provided shall extend to all matters of a legislative character not locally inapplicable, including power to create, consolidate, and reorganize the municipalities so far as may be necessary, and to provide and repeal laws and ordinances therefor; also the power to alter, amend, modify, or repeal any or all laws and ordinances of every character now in force in Puerto Rico or municipality or district thereof in so far as such alteration, amendment, modification, or repeal may be consistent with the provisions of this Act.

* * * * * * *

(48 U. S. C. 1946 ed., Sec. 821.)

"An Act to Provide Revenues for the People of Puerto Rico Through the Levying of a Certain Additional Income

Tax Which Shall Be Known as 'The Victory Tax'; to Appropriate Funds for the Administration of This Act, and for Other Purposes", approved December 7, 1942, and amended on May 10, 1943, and May 15, 1943. (Laws P. R., 1942, 3rd Sp. Session, p. 160; Laws P. R., 1943, pages 146 and 630 respectively).

"Section 1. A tax of five (5) per cent upon the gross income of every individual, in excess of fifteen dollars and five cents ($15.05) a week, for interest, rents, salaries, wages, day wages, fees, donations, compensations, remunerations, commissions, premiums, dividends, benefits in partnerships, whether civil or commercial, annuities, and any other income of whatever nature that is in cash, is determinable, and is not obtained from transactions in connection with contracts of purchase and sale in which those who receive it may have acted as contracting parties, or from reimbursements, returns of deposits, liquidations, inheritances, loans, payments on loans, and other similar operations, is hereby levied, and shall be collected and paid in addition to any other tax levied by the Income Tax Act of 1924, and up to six (6) months after the cessation of hostilities between the United States of America and Germany, Italy, and Japan. Without this being subject to interpretation as a limitation of the terms 'salaries', 'wages' and 'day wages', the same refer also to every kind of salaries, wages and day wages paid in Puerto Rico by the Government of the United States of America. In the case of rents, there shall be deducted also as an exemption any amount actually paid as interest for liens on the property producing the rent. Of the income subject to taxation by this Act there shall be deducted also, as exemptions, the amounts received as compensation for labor accidents; scholarships; the sums paid by the taxpayer during the taxable year for premiums on his life insurance policies, or on the life insurance policies of his wife or children, and on insurance policies against accidents, or for educational purposes, up to an aggregate insurance of twenty-five thousand (25,000) dollars; the sums obtained or collected on life insurance policies, or on insurance policies against accidents or for educational purposes during the life of the insured, and the

sums paid as compensation for cultural or artistic activities sponsored by the University of Puerto Rico or by any organization or association not for pecuniary profit. By gross income shall be understood every sum of money derived from the sources above enumerated as subject to taxation which is actually received by the taxpayer, or deposited or assigned in his favor or for his benefit. The word 'payment' as used in this Act shall have also that same meaning:

"In the case of contracts for the performance of works, labor, or services, by 'gross income' shall be understood the difference between the amount finally received by the contractor for the works, labor or services performed and the cost of the materials and labor, without including as part of the latter the salaries, wages or other remunerations credited or paid to the contractor for his personal work. In cases where the tax is to be withheld at its source and when, upon the making of full or partial payments to the taxpayer his actual income can not be determined by the withholding agent, said withholding agent shall limit himself to withholding, until said income is determined, the five (5) per cent tax only on the twenty (20) per cent of the amounts partially or fully paid to the contractors by virtue of the contract. After the works, labor, or service is performed, the contractor shall, on the first income tax return which he renders, set forth his actual income, as above defined, and shall accompany vouchers accrediting the corresponding deductions. This income tax return shall be considered as a claim, according to the provisions of Section 3, when the amount withheld is higher than the amount of the tax payable. The Treasurer may at any time notify the contractor about deficiencies in the payment of the tax if the amount or amounts withheld from the contractor, or the payment which he may ultimately make, do not cover the five (5) per cent of his taxable gross income, as said gross income has been defined above. Said deficiencies shall be collected according to the procedure established in the Act for the collection of the tax.

"The word 'individual' as used in this Act, shall mean a natural person and shall include: Residents of Puerto

Rico, married or single, without application of the provisions of the Civil Code relative to conjugal partnership, and all natural persons residing or domiciled outside of Puerto Rico, whether or not citizens of the United States of America and of Puerto Rico, if these persons receive or are to receive income from any one or more sources listed as taxable in this Act, and said income is derived from causes established in Puerto Rico and the source of payment is located in Puerto Rico.

"The tax levied by this Act shall be collected and paid from and after January 1, 1943.

"This additional income tax shall be known as 'The Victory Tax'. It may be so cited and shall be so cited in the body of this Act."

"Section 6. When the index of retail prices of the staple foods of Puerto Rico, as enumerated hereinafter, reaches the level of the month of June 1941, the exemption established for The Victory Tax levied in this Act shall be twelve dollars and four cents ($12.04) for each week and one dollar and seventy-two cents ($1.72) for each day, when it is proper to compute by days, according to Section 5. The index shall be computed by the Office of Statistics of the Governor of Puerto Rico on the basis of the prices reported by the Department of Agriculture and Commerce. The system of weighted relatives shall be used. The weighting shall be made on the basis of the consumption of these products by the laboring classes of Puerto Rico, as determined through the study of receipts and expenditures of the workmen of the Insular Department of Labor in cooperation with the Work Projects Administration (WPA). There shall be included for the computation of the index the following products: rice, beans, cornmeal, lard, ham, salt pork, codfish, onions, potatoes, plantains, *yautías*, sweet potatoes, milk, coffee, and sugar. The Governor of Puerto Rico shall promulgate, through proclamation, the date on which the prices of these products fall to the level of June 1941."

"Section 8. The Income Tax of 1924 shall be a law supplementary to this Act in everything not provided for herein."